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439497—57

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 1019

241 CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the Tax Court (R. 33–44)[1] is a memorandum opinion, and therefore is not officially reported. The *per curiam* opinion of the Court of Appeals (Pet. 1a–2a) is reported in 242 F. 2d 759.

JURISDICTION

The judgment of the Court of Appeals (Pet. 3a) was entered on March 28, 1957. The petition for a writ of certiorari was filed on May 22, 1957. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

[1] Record references are to the appendix to the taxpayer's brief filed in the Court of Appeals.

QUESTION PRESENTED

Whether advances made to the taxpayer by its stockholders were contributions to capital, and not loans upon which interest was properly accruable under Section 23 (b) of the Internal Revenue Code of 1939.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness * * *.
>
> * * * * *
>
> (26 U. S. C. 1952 ed., Sec. 23.)
>
> SEC. 115. DISTRIBUTIONS BY CORPORATIONS.
>
> (a) *Definition of Dividend.*—The term "dividend" * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year * * *.
>
> * * * * *
>
> (26 U. S. C. 1952 ed., Sec. 115.)

STATEMENT

The facts as found by the Tax Court (R. 34–40) may be summarized as follows:

The taxpayer corporation was organized in 1945,

under the laws of New York, by a group of five individuals for the purpose of taking title to certain real property in New York City, the purchase price of which was about $1,840,000. (R. 34.) The original plan was for the taxpayer to assume a first mortgage of about $1,540,000 and obtain a second mortgage of $250,000, and for the stockholders to advance $50,000, of which $3,000 was to be considered as capital. (R. 34–35.) Later, the stockholders found that they would have to advance $150,000, of which $3,000 was to be capital and the balance, or $147,000, was to be regarded as a loan. The taxpayer issued 30 shares of stock with a par value of $100 each; 5 shares to each of four stockholders, and 10 shares to the remaining stockholder; the stockholders made additional advances in the aggregate amount of $147,000 in exact proportion to their stockholdings. (R. 35.)

The taxpayer's minutes of August 1, 1945, include the following resolution (R. 36–37):

> On motion duly made, seconded and unanimously carried, it was
>
> *Further resolved* that the corporation borrow such additional moneys as it may require from time to time from Jacob R. Schiff, Samuel Rudin, Edward Rudin, Seymour H. Gross and Manuel G. Sydney, for the purpose of carrying on its regular business, and any such loans shall bear interest at the rate of 10% per annum.

In addition to the advances of $147,000, referred to above, the stockholders made additional advances during the years 1945 to 1948, inclusive, which were, for the most part, in proportion to their stockholdings. (R. 37, 41.)

The advances were not evidenced by notes or similar instruments, and were not secured by the pledge of collateral. They were carried on the taxpayer's books as loans payable, and were not subordinated to the claims of general creditors. There was no definite arrangement as to payment of either principal or interest. Such payment was entirely dependent upon the taxpayer's earnings. There was an agreement among the stockholders restricting the transfer of stock by the stockholders, and there was testimony by one of the stockholders that if notes had been issued for advances to the stockholders, such notes would have been subject to the same restrictions as to transfer. (R. 37–38.)

All of the advances made by the stockholders to the taxpayer were repaid during the years 1948 through 1952; however, none of the interest was paid until 1952, at which time about $16,000 was paid, leaving about $73,000 unpaid at the time of the hearing before the Tax Court. (R. 39–40.) The taxpayer did not pay the interest as it accrued, because it did not have sufficient funds. It paid off the principal as frequently as it could, and so reduced interest charges. The taxpayer did not accrue interest on the accrued unpaid interest. (R. 39.)

The taxpayer, which kept its books on an accrual basis (R. 34), accrued interest at the rate of 10 percent per annum, pursuant to the corporate resolution dated August 1, 1945 (R. 39). Interest deductions were claimed by the taxpayer on its federal income tax returns for the taxable years ended June 30, 1946, June 30, 1947, and June 30, 1948, in the amounts of

$14,709.49, $17,371.16, and $17,995.84, respectively, with respect to its accruals of interest on stockholders' advances. The Commissioner disallowed the deductions, and the Tax Court upheld him on the ground that the advances to the taxpayer by its stockholders were contributions to capital and not loans. (R. 40, 42.) The Court of Appeals affirmed the decision of the Tax Court in a *per curiam* opinion. (Pet. 1a–2a.)

ARGUMENT

The decision of the court below is correct. It affirms the Tax Court's conclusion that the advances made to the taxpayer by its five stockholders, under the circumstances of this case, were contributions to capital and not loans upon which interest was properly accruable under Section 23 (b) of the Internal Revenue Code of 1939, *supra*, p. 2. The Tax Court properly applied the principles established by this Court in *John Kelley Co.* v. *Commissioner* (decided with *Talbot Mills* v. *Commissioner*), 326 U. S. 521, where it was held that whether a corporate payment[*] constitutes deductible interest or a nondeductible dividend distribution presents a question of ultimate fact in each case, depending upon whether the true relationship of the parties is that of debtor-creditor or corporation-stockholder. In determining that relationship, this Court held that consideration should be given to the characteristics of the obligations in question and

[*] The taxpayer here was on an accrual basis. (R. 34.) It did not make any interest payments until 1952, which was after the taxable years; at that time it paid interest aggregating about $16,000; the balance, or about $73,000, had not been paid at the time of the hearing in the Tax Court. (R. 39–40.)

the surrounding circumstances, and remarked that no one characteristic can be said to be decisive. The Tax Court applied those principles here. (R. 41.)

In the instant case, the Tax Court found that the stated capital of $3,000 was wholly indaequate to finance the purchase of the properties (the cost of which was more than $1,800,000 (R. 34)), and that the balance of the initial advances, $147,000. represented part of the purchase price; that the above-mentioned initial advances were in exact proportion to the stock interests of the shareholders; and that when it was found later that additional funds were required by the taxpayer, the majority of such additional advances were made according to the equity interests of the stockholders. (R. 43–44.) The Tax Court also took into consideration the fact that there were no notes, and no evidence of a fixed date of payment. (R. 42-43.) There was substantial evidence to support these findings (R. 34–40), as the Court of Appeals held in its *per curiam* opinion (Pet. 1a–2a). In view of the concurrent factual determinations of the courts below, and the absence of a conflict of decisions,[3] further review is not warranted. Cf. *Gooding Amusement Co.* v. *Commissioner*, 236 F. 2d 159 (C. A. 6th), certiorari denied, 352 U. S. 1031, and *Gregg Co. of Delaware* v. *Commissioner*, 239 F. 2d 498 (C. A. 2d), certiorari denied, 353 U. S. 946.

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[3] In *Miller's Estate* v. *Commissioner*, 239 F. 2d 729 (C. A. 9th), and *Kraft Foods Co.* v. *Commissioner*, 232 F. 2d 118 (C. A. 2d) (Pet. 14), there were written evidences of indebtedness, whereas here there were no notes and no maturity dates for repayment of the advances (R. 37, 42). In *Rowan* v.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JUNE 1957.

United States, 219 F. 2d 51 (C. A. 5th) (Pet. 10), the initial payment was not made for acquisition of capital assets, while it was in this case. (R. 34–36.) In *Pierce Estates* v. *Commissioner*, 195 F. 2d 475 (C. A. 3d) (Pet. 11), there was no question as to whether the advances by the stockholders were contributions to capital or loans; the Tax Court had decided that the advances were loans, and the Commissioner did not take a cross appeal on that issue; the only issue on appeal was the amount of interest which the taxpayer could accrue as a deduction in the taxable year, and that depended upon whether, under the terms of the notes, accumulated interest accrued in the taxable year.